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Th Jefferson

Innovative and Workable Ideas for Building Schools

Public/Private Partnerships: A New Way to Fund and Build Schools

By David Guhse

October 2001

Thomas Jefferson Institute for Public Policy

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Thomas Jefferson Institute for Public Policy
9035 Golden Sunset Lane
Springfield, Virginia 22153
703/440-9447
email: mikethompson@erols.com
website: www.thomasjeffersoninst.org

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Foreword

All over Virginia, from school district to school district, there is a strong need for new schools and rebuilding older schools. A few years ago, the General Assembly put a price tag on school construction needs in Virginia at several billion dollars. These needs are not yet met and are likely to be growing.

This study is presented to our public policy leaders and our opinion leaders in an effort to bring to the table for discussion school construction methods that have been successful in other parts of the country and in Canada. These ideas might well find success here in Virginia as well. They certainly deserve a full and impartial hearing by our public school leaders – Superintendents and School Board Members. The General Assembly should look into these construction ideas as it grapples with the deficit of adequate classroom space.

Several specific cases are outlined in this study for our public policy leaders to review and consider. Those companies and those school districts that have used these public/private partnerships should be brought to Virginia to discuss these successes and to outline how they proceeded and what they would recommend we do here in the Commonwealth.

Imagine if the Greenville County, South Carolina experience proves successful. In that case (see page 5), the school district had a 24-year plan for the school needs they faced last year – in 2000. By turning to the private sector and a creative financing structure, they can save 40% on the overall costs and reduce the time line from 24 years to only 4 years!

If these savings were only half of those projected, it would be worth billions of dollars to our schools systems in Virginia to turn to similar ideas for new schools and rebuilding old schools.

At a minimum, the ideas outlined in this paper should be seriously discussed in our school districts and the General Assembly. Each situation will be different depending on needs, financing arrangements, and the private company brought on board. The contracts with the private construction companies need to be carefully crafted and the experience of the other school districts around the country can be beneficial.

The ideas in this study are worthy of consideration. The use of private sector construction companies, stepping outside the normal bond-to-build process, and looking at various financing arrangements should become pieces of the overall puzzle used to meet the school capacity needs in our state.

Today, with the construction industry looking for work and interest rates lower than they have been in thirty years, it is the right time to move in this direction and to see if the advantages found in other communities around our nation can be replicated here in Virginia.

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Michael W. Thompson
Chairman and President
Thomas Jefferson Institute for Public Policy
October 2001

Innovative and Workable Ideas for Building Schools

Public/Private Partnerships: A New Way to Fund and Build Schools

By David Guhse

Executive Summary

School districts around the country face the need to renovate school buildings and build new schools to accommodate population growth and change. According to one estimate, it will cost a staggering \$300 billion to bring meet the current infrastructure needs of the nation's school districts.ⁱ Despite the fact that investment in school construction is higher now than it has ever been,ⁱⁱ at the current rate of spending on school construction, a first grader in 2001 will be mailing college graduation announcements by the time today's school construction and renovation needs have been fully addressed.

Many Virginia counties face the same challenge. For example, in Fairfax County, home to 13% of all Virginia elementary and secondary students,ⁱⁱⁱ five-year school capital needs exceed \$1 billion! Even the massive \$377 million bond referendum will address less than half of the identified unfunded school capital improvement needs facing Fairfax county.^{iv} Critically important projects such as construction of a new South County high school and renovations at Woodson and Edison high schools receive only planning funds, effectively delaying completion of these projects for years.^v

Out of necessity, politicians, school district superintendents, school board members, parents, and even the construction industry, have begun looking beyond the traditional tax and borrow methods of school construction funding toward an emerging public/private development trend. Politicians as diverse as President Bush, Florida Senator Bob Graham, and New York Mayoral candidate Mark Green agree: the time has come to ease the way for private entities to fund school construction in innovative lease back arrangements. Even the American Society of Civil Engineers recently encouraged school districts to seek "alternative financing, including lease financing, and financing/ownership/use arrangements to facilitate construction."^{vi} More and more states are taking notice of the success of these new ways of financing school construction. As early as 1998, the Washington State House of Representatives Task Force on School Construction Financing recommended that its school districts have the option to acquire facilities with lease/purchase agreements, reasoning that "long-term lease purchase agreements would provide an option to the traditional construction process by enabling districts to quickly respond to explosive enrollment growth and changing student demographics with fewer up-front costs."^{vii}

Based on the experiences of school districts around the country, it is increasingly clear that no school district with unmet school construction, expansion, and renovation needs can afford to ignore the option of public/private arrangements to address all or part of their comprehensive infrastructure plan. What distinguishes public/private projects from

traditional school construction methods are the incentives public entities give private developers to work faster, smarter, and take on more of the financial risk and reward. For example, in a public/private financing arrangement, the control and ownership of the school building will typically remain with the financier, often a private development company, for the life of the lease. In many such arrangements, investor profits will be derived from revenue raised from renting the facilities during non-school hours. At the end of the lease, ownership either reverts to the school district, or remains with the private investor, depending on the negotiated terms.

Public/private development has shown dramatic results in terms of time saved, money saved, final product, and completion of projects that traditional financing could not support.

- *Public/private projects are typically built more quickly, for less money, or both.* When private entities take on an increased role in school construction projects, schools often get built faster at a reduced cost to school districts. In Pembroke Pines, Florida a new school was built using public/private *financing in less than two years at a savings of around \$8,600 per student station, 34% to 39% lower than comparable student station costs in Broward County of \$13,000 to \$14,000.*^{viii} Results like that convinced the Greenville South Carolina school district to commit to a massive public/private construction and renovation plan *estimated to save 20 years time and over \$500 million -- a 40% savings* (pages 4 and 5)
- *The facilities created frequently serve as both a school and a community center.* When private entities finance public school construction, they often build facilities that not only meet, but also exceed local school district needs. Often, an important source of revenue to private investors in such arrangements is rental of the facility to community organizations during non-school hours, so the facility must be attractive to a range of civic and educational groups. For example, the new high school in Niagara Falls, New York built with private financing, is on the technological and architectural cutting edge. The proud community has made the building more than just a new school, but a new part of local civic life (page 5).
- *Some school districts have successfully turned to public/private financing when traditional financing methods have failed.* School districts in economically depressed areas, or other areas where voters oppose increased taxes or debt, have successfully turned to public/private financing arrangements. For example, in the District of Columbia a 75-year-old bilingual school was listed to be closed before parents and private developers created a plan to completely rebuild the school at no cost to District taxpayers. In the Houston Independent School District, four-and-a-half years after a bond rejection, two new high schools were open for business using public/private financing. (page 6)

Finally, recent changes to the federal tax code will pave the way for more public/private arrangements in the future.

Case Studies

The following case studies illustrate how far and quickly public/private financing of school construction has spread from its development in Canada in 1997. Each case study describes how an individual school district partnered with one or more private developers to meet the unique opportunities and challenges facing its school children and community.

Canada: necessity is the mother of invention

Canadians pioneered the public/private partnership approach to school facility development. In 1997, Nova Scotia faced high unemployment and declining revenues from traditional income sources such as the North Atlantic fishing industry. At the same time they faced a need to build new public schools. Officials knew that traditional methods of public financing were not available to them. They were not in a position to raise local taxes or take on new local debt, and they knew additional federal assistance would not be forthcoming. So, they innovated: they found a way to get the private sector excited about investing private resources in public school construction.

Government leaders approached private developers with an unusual offer. If the developers would agree to finance and build a school according to plans provided by the municipality, the municipality would agree to lease the school back from the developer for 20 to 30 years at payments that would total 85% of the capitalized cost of the project. To make up the remaining 15% of cost and provide for profits, the developer would retain ownership of the building, and would have the right to rent the building for other, compatible, uses during non-school hours (typically before 8:30 a.m. and after 3:30 p.m.). At the end of the lease, the school system would have the option to purchase the building. Examples of compatible uses would include provision of child-care services, higher education instruction, tutoring, as well as hosting community events and events sponsored by local religious and non-profit groups.

By the start of the 2000/2001 school year, 22 new schools were opened with 11 more on the way. Soon, school districts in England, Scotland and the United States began applying the lessons of Nova Scotia to their own local situations.^{ix} A recent study by a professor at the University of British Columbia concluded that a similar public/private elementary school construction project carried out in Abbotsford, British Columbia resulted in savings of more than 10%, and was completed in only 12 months. The study concluded that public/private financing “proves schools can be built at lower cost, freeing public dollars for other uses.”^x

Another Canadian province developed a similar public/private development solution with one significant difference: instead of constructing new facilities, the local school district leased unoccupied commercial property, which had been renovated to accommodate school use. As early as 1994, the Edmonton Public School District in Edmonton, Alberta entered into an arrangement in which a landlord agreed to pay to convert unoccupied space in a commercial building to fit school district specifications, and the school district

then leased the space for public school instruction. Because this unique method of school expansion was generally cheaper and gave the school district greater flexibility, the Edmonton Public School District sought out more such arrangements, and now houses seven schools in commercial space.^{xi}

Florida: eliminates roadblocks to innovation

In the United States, Florida has been a leader of private-public school partnerships. As early as 1990, Florida began to allow public use of the design-build method of construction. The design-build method is unique in that the customer deals with one entity for both the designing and construction aspects of a project.^{xii} The method was first used with courthouses and jails, and then spread to the state's larger school districts, Dade, Palm Beach, Broward, and Duvall.^{xiii} In 1996, Florida Charter School legislation further reduced roadblocks to innovative school construction and financing. In 1997, the city of Pembroke Pines in Broward County contracted with Haskell Educational Services (HES), a subsidiary of The Haskell Companies, to design, build, and manage a ground breaking charter school project. In this case, the municipality funded the construction with a tax-exempt bond, and then leased the building to HES to operate a charter school. The school was ready for use in August 1998 at a cost saving of \$4,400 to \$5,400 per student station compared to other school construction costs in Broward County.^{xiv} Based on the success of the primary school, a middle school was opened in August 1999, and a high school opened in August 2000. Each structure has both a school and a community function. According to Senior Project Director, Steven Wells, "By bringing all the parties and functions together, we generated a cost-effective, community-use facility with nonduplication of services. The lights go on here at 7 a.m. and they'll still be on at 11 p.m. I believe economics and community needs will drive facilities in this direction." Community uses built into the high school include a county public library, community college satellite campus, environmental park, Olympic-size swimming pool, tennis courts, play fields, and a food court.^{xv} As a result, The Design-Build Institute of America recognized Pembroke Pines Mayor Alex Fekete and City Manager Charlie Dodge with Special Recognition awards in the area of Distinguished Leadership in 2000.

Florida is a leader in another variation in public/private school innovation: the workplace school, now expanded to include workplace charter schools. In 1999, Ryder System Inc., the world's largest truck leasing and rental company opened the nation's first workplace charter school. Ryder agreed to pay the \$4 million construction cost to build the state-of-the-art facility located adjacent to the Ryder System headquarters, and contracted with Charter Schools USA, Inc. to handle the day-to-day management. In exchange, Ryder employee's children have preference for attendance, making Ryder an attractive employer (although 90 percent of school's 1999-2000 enrollment came from non-Ryder families). The school was designed, constructed, and ready for students in less than nine months, over four years faster than typical construction projects,^{xvi} and is already a tremendous success both in terms of parental satisfaction and student academic achievement.^{xvii}

South Carolina: a plan to save \$500 million and 20 years

In September 2000, the Greenville County, South Carolina School Board approved a \$780 million plan allowing the private firm Institutional Resources to build or remodel 72 schools within four years. The board said if it were to complete the plan itself, it would take 24 years and require \$1.3 billion. The developer will also take over 18 ongoing construction projects. Typical of the individual nature of such private-public financing arrangements, the Greenville school board financing plan takes advantage of local precedent. Relying on a financing arrangement similar to the ones used by the Greenville Hospital System and upheld by the South Carolina Supreme Court, the school board plans to create a non-profit company to issue bonds to pay for the construction.^{xviii} A citizens group has temporarily slowed progress by filing a suit alleging that the non-profit group and the school board are one in the same, therefore requiring that any bond be subject to a referendum before being issued. However, the Greenville School Board is relying on previous State Supreme Court precedent and an opinion by the State's Attorney General supporting the school board plan, to clear the plan for rapid implementation.^{xix}

New York: Niagara Falls success

The Niagara Falls, New York School District took notice of school construction innovations in nearby Canada and within the United States. New York law did not allow school districts to lease buildings, so in 1996 an exception was approved by the legislature to allow the Niagara City School District to enter into a private-public construction and lease back arrangement. The legislature also approved exemption from certain construction hiring requirements, and allowed the issuance of state-backed "certificates of participation" which the project manager and financier, Honeywell, Inc., sold to raise funds.^{xx} A separate organization, the Hillier Group, Inc., provided the design services. The project was completed in 18 months, much sooner than would be typical, at a savings of about \$10 million to \$12 million (10% to 15%) which was reinvested in project upgrades. Niagara Falls leases the facility for \$5 million per year, and will purchase the facility after 30 years for one dollar.^{xxi} The city helped fund the project by selling the two aging high schools^{xxii} (one of which, because of a leaky gym roof, had the distinction of having to cancel basketball games due to rain^{xxiii}) with one new state-of-the-art learning center fit to meet the needs of not only the student population but also the community at large.^{xxiv} Honeywell, Inc. took on the challenge of financing the construction, relying on the Hillier Group Inc. to design the structure to fit the specifications developed by the school district. Completed in September 2000, the project has been such a success that a number of other New York school districts are seriously examining whether a similar arrangement could work for them. For example, the State legislature has already cleared the way for the neighboring Buffalo, NY School District to renovate its schools and conduct new construction using the same kind of private-public development arrangement.^{xxv}

District of Columbia: First School Construction in 20 years

Concerned parents in Washington, DC conceived and brought together a public/private partnership that resulted in the complete rebuilding of a 75-year old bilingual public elementary school *at no cost* to the District. The James F. Oyster Bilingual Public Elementary School was scheduled to be closed because the District could not afford to repair and renovate it. In consultation with Public/Private Development of America, the parent's group determined that the school's only valuable asset was the 1.67 acres of land on which the school was located. Working with the District of Columbia Public Schools and the District of Columbia government, the parents group brought in a private real estate firm, LCOR, to finance, design, and construct a new Oyster school in exchange for part of the school land, on which LCOR built a 211-unit residential apartment building. All taxes LCOR owes from the building are dedicated to payment of an \$11 million D.C. bond issue and will fully pay for the bond at no cost to the District. On June 14, 2001, the new James F. Oyster school opened: the first new District of Columbia public school to be built in the last 20 years.^{xxvi} The project has been recognized with awards from the International Economic Development Council and The National Council for Public-Private Partnerships.

Houston, Texas: Education Secretary's School District Saves Time and Money

In the Independent School District of Houston, formerly led by Secretary of Education Rod Paige, two "state-of-the-art" campuses were funded through lease-purchase agreements and tax increment reinvestment zones created by the City of Houston.^{xxvii} The projects were completed a year faster than normal at a savings of \$20 million.^{xxviii} Caesar E. Chavez High School and Westside High School both opened in August 2000. The lease/purchase arrangement followed a May 1996 vote disapproving a traditional bond to fund the needed schools. The Texas legislature then passed legislation to allow alternative delivery/capitalization systems, and the Houston Independent School District pursued private financing solutions. Gilbane Building Company reached agreement with the school district to construct the schools according to a mutually acceptable schedule for a specific price. Funds were raised through a bond issue offered by the Houston Independent School District Public Facility Corporation, a public, non-profit entity created by the school district. The School district leases the schools from The Houston Independent School District Public Facility Corporation for the duration of the agreement.^{xxix}

Changing the Federal Tax Code to encourage public/private financing

The federal government has taken note of the successes of public/private financing as well. In the 106th Congress, Florida Senator Bob Graham (D), joined by Florida Representative Clay Shaw (R), proposed a tax incentive that would allow private companies who contract to construct public schools, to finance their construction projects with tax-free bonds. Known as "private activity bonds", this option was already available to private contractors for the construction of public purpose facilities such as airports,

docks, and hazardous waste facilities. The Graham/Shaw legislation would simply add public schools to the list.^{xxx}

That idea was picked up by presidential candidate George W. Bush and eventually included in tax reform legislation passed by congress in 2001. The provision puts private financiers on the same footing as public financiers when structuring a school construction-financing plan. Prior to the change, the federal tax code had the effect of discouraging private financing of public schools. A bond issuer who can assure a buyer that all earnings from interest payments are exempt from federal tax can pay a bond buyer a much lower interest rate. All other things being equal, the average bond buyer would much prefer receiving 4.5% interest that is free of subsequent tax, than receive a higher interest rate of, for example, 6%, which leaves only 4% in true earnings after paying taxes. From the perspective of the bond issuer, the difference between paying 4.5% interest and 6% interest to bond holders can make or break many projects. Giving private contractors the chance to pay substantially lower interest rates to bond holders dramatically reduces the overall cost of private school construction projects. By making it easier for private contractors to raise capital, more public/private partnerships for school construction will be possible.

Initially, the amount of tax-exempt school construction bonds that any state could qualify for would be limited on the basis of state population. It is estimated that Virginia, for example, with a population of 7 million, could issue as much as \$70 million in such bonds per year.^{xxxi} In Fairfax County, \$70 million represents the cost of building three elementary schools, one and a half middle schools, or one high school.

Conclusion

Each project reviewed here, unique in many details, shares a common value: innovation. Public/private innovation made possible construction of a workplace charter school at Ryder Inc. headquarters at no cost to the West Dade, FL taxpayers. Public/private innovation made possible the total renovation of the James F. Oyster Bilingual Elementary School at no cost to District of Columbia taxpayers. Public/private innovation is saving time and money on construction projects in school districts around the country.

Private contractors involved in the Houston and Florida public/private partnerships have expressed interest in exploring similar projects in Northern Virginia. Other contractors would likely be interested as well. Earlier this year when the Buffalo, New York Joint School Construction Board sought proposals to rebuild its schools, it received responses from 12 major firms. Buffalo Mayor Anthony Masiello reacted by saying “We’ve been saying all along that we’re on to something big, and the quality of the applications shows it’s the real thing.”^{xxxii} Based on the experiences of school districts around the country, it is increasingly clear that no school district with unmet school construction, expansion, and renovation needs can afford to ignore the option of public/private arrangements to address all or part of their comprehensive infrastructure plan.

Endnotes

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- ⁱ *Overcrowding: A National Problem/A National Solution*, a fact sheet by the Neighborhood Capital Budget Group available on their web site, www.ncbg.org.
- ⁱⁱ Abramson, Paul, *School Construction Report 2001*, *School Planning and Management Magazine*, p. 1, 2.
- ⁱⁱⁱ Fairfax County Public Schools statistics, www.fcps.k12.va.us/about/stats.htm
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- ^v Fairfax County Public Schools, *Bond Referendum Facts, November 6, 2001*, p.p. 3,4.
- ^{vi} American Society of Civil Engineers, Issue Brief, Schools, available at <http://www.asce.org/reportcard/index.cfm?reaction=factsheet&page=5>.
- ^{vii} As reported in *Executive's Task Force on School Construction Financing Alternatives*, Ron Sims, Executive, King County, Washington. www.metrokc.gov/smartgrowth/schoolreport.htm
- ^{viii} Town of Davie Workshop Meeting Minutes about a presentation by Mayor Alex Fekete of Pembroke Pines, FL to the Town of Davie, September 28, 1996.
- ^{ix} Utt, Ronald D., Ph.D., *How Public-Private Partnerships Can Facilitate Public School Construction*, The Heritage Foundation Backgrounder No. 1257, February 23, 1999, pp. 4-7, and Utt, Ronald D., Ph.D., *New Tax Law Boosts School Construction with Public-Private Partnerships*, The Heritage Foundation Backgrounder, No. 1463, August 8, 2001, p. 5.
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- ^{xiv} Town of Davie Workshop Meeting Minutes, September 28, 1998.
- ^{xv} Mathew, pp. 3, 4.
- ^{xvi} *Left in the Dust*, Fairfax Journal Opinion, August 21, 2001, p. A4.
- ^{xvii} Snell, Lisa, *Workplace Charter Schools*, Reason E-Brief, May 2001.
- ^{xviii} Zacher, Jason, *School Building Plan OK'd*, The Greenville News, July 11, 2001.
- ^{xix} *School-Building Plan Headed To Court*, The CarolinaChannel.com, August 20, 2001.
- ^{xx} Farrell, Jodi Milancer, *How a Private Firm Bankrolls a Public School*, Office.com, Feb 23, 2001.
- ^{xxi} *A Dumb Idea*, The Fairfax Journal Editorial, October 14, 2001.
- ^{xxii} *Unique private sector financing provides a new high school in Niagara Falls*, Minnesota Issue Watch, April 2001, available at www.mnplan.state.mn.us/issues/scan.htm?Id=383.
- ^{xxiii} Zernike, Kate, *Niagara Falls Turns to Honeywell*, New York Times, College Times, January 24, 2001.
- ^{xxiv} Office.com Public-Private Schools are a Design Challenge, by Adam Katz-Stone, Feb. 26, 2001.
- ^{xxv} Collison, Kevin, *12 Proposals Received to Redo Schools*, Buffalo News, July 15, 2001.
- ^{xxvi} *Oyster Public/Private Development Partnership*, at www.21csf.org/csf-home/Oyster/oyster/oyster_brief.htm.
- ^{xxvii} *State of the Schools 2000*, Houston Independent School District, available at www.houstonisd.org/Pubs/SOS/2000/Goal3.htm.
- ^{xxviii} *Left in the Dust*, Fairfax Journal Editorial, August 21, 2001, p. A4.
- ^{xxix} *Cast In Point, Houston Independent School District, Lease/purchase: An alternative tool for school financing and construction*, available at Gilbaneco.com.
- ^{xxx} Statement of Honorable E. Clay Shaw, Jr., in the House of Representatives, Wednesday, July 14, 1999, Congressional Record, E1533.
- ^{xxxi} Utt, *The New Tax Law Boosts School Construction with Public-Private Partnerships*, p. 2.
- ^{xxxii} Collinson, *12 Proposals Received to Redo Schools*.

Resources for Building Schools Through Public/Private Partnerships

(This is not a complete listing, but only those found while researching and writing this study.
There are other firms that offer expertise, legal and finance guidance for this process.)

Concept and Local Government Outreach:

Commonwealth Competition Council
Phil Bomersheim, Executive Director
1500 E. Franklin Street
Richmond, VA 23219
804/786-3088

Construction firms:

Gilbane Properties, Inc.
William Choquette, Senior Vice President
4330 East-West Highway, Suite 314
Bethesda, Maryland 20814
301/718-8860

Colin Kane
7 Jackson Walkway
Providence, RI 02903
401/456-5644

Centex Construction Company
David C. Bertwistle, Vice President
3924 Pender Drive
Fairfax, Virginia 22030
703/273-3311

The Haskell Company
Douglas R. Storer
Director – Education Division
114 East New England Avenue, Suite 5
Winter Park, Florida 32789
407/599-9800

Donald Feather
1130 Situs Court, Suite 230
Raleigh, NC 27606
919/233-9800

Stainback Public/Private Real Estate, LLC

John Stainback
3 Somerset Lane
Malvern, PA 19355
610/935-8661
FAX 610/935-5734
jstainback@sppre.com
www.sppre.com

AECOM Enterprises

Frank Wilson
515 South Flower Street
Los Angeles, CA 90071-2201
213/593-8200

Legal Firms:

Binghan Dana, LLP

Roger D. Feldman
1120 20th Street, Suite 800
Washington, DC 20036-3406
202/778-3181

McGuire Woods, LLP

Arthur E. Anderson, III
One James Center
9901 East Cary Street
Richmond, Virginia 23219-4030
804/779-4366

Finance:

Monticello Capital

Michael N. Pocalyko
12932 Oak Lawn Place
Oak Hill, VA 20171
703/264-7882

Jerry Ford Associates, Inc.

Jerry Ford
2602 South Dundee Street
Tampa, FL 33629

About the Author

Dave Guhse is a lawyer who has worked in Washington for 16 years. He has held senior policy positions in the House of Representatives, including service to a member of the House Education and the Workforce Committee, and the U.S. Senate. Among his many legislative responsibilities, Mr. Guhse tracked education legislation and trends, analyzed the U.S. Department of Education budget, and advised on education related votes. Most recently, he spent six years representing the public broadcasting industry before Congress.

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*"... a wise and frugal government, which shall
restrain men from injuring one another, shall leave
them otherwise free to regulate their own pursuits of
industry and improvement, and shall not take from
the mouth of labor the bread it has earned. This is the
sum of good government, and this is necessary to close
the circle of our felicities."*

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1801

Thomas Jefferson Institute for Public Policy
9035 Golden Sunset Lane
Springfield, VA 22153
703/440-9447
Mikethompson@erols.com
www.thomasjeffersoninst.org